June 7, 2010

Federal Reserve Bank of New York
33 Liberty Street
New York, New York 10045

Re: Request for Comments – Tri-party Repo Infrastructure Reforms

Jordan & Jordan appreciates the opportunity to respond to the white paper published by The Federal Reserve Bank of New York ("FRBNY" or "The Bank") on May 17, 2010 discussing Tri-Party Repo Infrastructure Reform.

Jordan & Jordan would like to commend the Bank's Payments Risk Committee on its actions in forming the Tri-Party Repo Infrastructure Reform Task Force to address the many concerns presented by the critical tri-party financing function. We would also like to congratulate the Task Force for their significant effort in preparing their report and recommendations to date, although there remains much work to be done.

Jordan & Jordan is a professional services firm that provides business and technology solutions to the financial services industry. Having been engaged in past years by The Bond Market Association (now SIFMA) as project manager and subject matter experts to implement the recommendations made by the Fed-sponsored private-sector Working Group on NewBank Implementation, we have had extensive dealings with many key players in the tri-party markets, and developed a firm grasp of many of the issues. We believe that the insights we gained on the NewBank project give us a unique perspective on this important market and we have been looking forward to the publication of the final report and recommendations of the Tri-Party Repo Infrastructure Task Force.

For your consideration, we submit the following responses to your questions:

1. Have the sources of systemic risk in the tri-party repo market been identified correctly? What additional vulnerabilities or material risks should be considered in evaluating the need for reforms in this critical market?

The FRBNY did an excellent job of presenting the systemic risks inherent in the tri-party repo market. We do see one area that we believe these recommendations do not fully address pertaining to the loss of confidence in a clearing bank as described in the section on "Market dependence on intraday credit" on page 14.

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It would appear that the changes proposed by the Task Force to substantially eliminate 90% of intra-day risk are considered to have solved the problems originally identified in the NewBank project. However, we suspect that the investors will still remove all tri-party financing from dealers who clear at a particular clearing bank if that bank suffered a loss of confidence. Our primary concern is that many large investors have specific credit criteria that a bank must meet in order to be utilized as a "custodian". Should a bank fall below the criteria, these investors will be required by their policies to avoid using that bank as a tri-party custodian.

An additional concern would be the exposure associated with the increase in term trades that has been proposed. Investors would likely be very averse to committing their funds to a dealer on this basis if they know that payment would need to flow through their demand deposit accounts at a troubled bank on a future date.

Lastly, you have stated that the largest cash investors supply $100 billion or more to the tri-party markets on a daily basis. At best, even assuming that the risk associated with 90% of that amount could be eliminated with implementation of these Task Force recommendations, $10 billion (or $5 billion assuming the funds are divided between the two banks) remains at risk.

We believe that this combination might cause many of the major investors to pull their funding from dealers at the troubled clearing bank creating a severe liquidity crisis for those institutions. Given this, the FRBNY may want to consider the final recommendations of the NewBank Steering Committee to see if there would be benefit in implementing them in conjunction with the current Task Force proposals.

2. Are the recommendations proposed by the task force appropriate and adequate to address the policy concerns articulated in this paper?
a) Please comment on specific recommendations that you think are most likely to be effective.

The steps taken to keep the credit exposure with the cash investors in lieu of moving the exposure to the clearing banks would appear to be the most effective recommendations. In particular, the combination of: a) developing an auto-substitution capability that would allow for the continuous lockup of collateral for term trades; and, b) maintaining collateralization of expiring trades until much later in the day, should go a long way towards eliminating the current daylight exposure of the clearing banks. The proposals for a more robust three-way confirmation process and standardized settlement times are critical pre-requisites for this and should be able to be developed in a timely manner.

The proposal to publish key data regarding the composition/concentration of tri-party repo collateral along with margin information for tri-party loans will also be a valuable tool for all concerned. In support of efforts to achieve greater transparency, we trust that the clearing banks and FRBNY have been able to satisfy any dealer confidentiality concerns in this regard.

b) Please comment on specific recommendations that you believe will not be effective.

We are in agreement with the FRBNY's statement regarding the likelihood that cash investors will rapidly flee from a dealer that shows any signs of weakness in spite of the recommendations made by the Task Force. Experience has shown that for many large investors, their primary consideration in making tri-party loans is the quality of the counterparty. Although the existence of collateral and more robust processes for liquidation and liquidity are very much needed in the event of default, even the most sophisticated programs are unlikely to change the fact that investors would rapidly cease doing business with any firm showing weakness.

While we firmly believe the concept of auto-substitution can be highly effective, there are two scenarios that should be considered carefully when designing the auto-substitution process. 1) The absence of same day pricing might create situations that could cause cash investors to balk at utilization of the process. Substituting a 10-year Note for a Treasury Bill on a day when Treasury prices are moving down significantly could leave them under-collateralized if prior night prices were used. 2) Another consideration would be the handling of principal & interest payments on any collateral held on a tri-party loan. To give these payments to the dealer without any adjustment to the collateralization of the investor could be problematic.

c) Please comment on specific recommendations that you believe may have unintended consequences.

Although Jordan & Jordan has not identified any unintended consequences associated with any specific recommendation, we are concerned that the collective burden of the many changes suggested for the cash investors may cause them to consider leaving the tri-party market and invest in other, less demanding products. For instance, we have seen a reluctance of the buy-side to make significant modifications to their operational procedures such as automating messaging for block trade confirmations and fixed income account allocations.

Furthermore, we have found that many tri-party constituents are unaware of their exposures and their obligations in a tri-party transaction. Implementation of some of these recommendations will require broad education of the risks and commitments involved, which may cause all but the top tier investors to back away. Because the success of many of the Task Force recommendations are dependent on the full cooperation of the investor, it is unclear as to the source or strength of motivation necessary for the buy-side to maintain current levels of interest in this type of investment.

d) Are there additional specific measures within the general approach proposed in the task force report that should be considered?

Jordan & Jordan has no comment.

3. Are the task force recommendations, including targets for reduction of intraday credit extension by clearing banks, achievable in the timeframes outlined? What barriers or challenges to implementation do you anticipate?

Jordan & Jordan is not comfortable providing comment on the time frames proposed, given the current state of communication between the three parties involved is not known to us, and the detailed project plan for the auto-substitution process has not yet been published. However, to the extent that real-time messaging for confirmation of block trades and allocations instructions can help facilitate reduction of intraday credit, we are confident that the standard FIX protocol messages can meet these needs. While most market participants today are FIX-enabled on the equity side of their businesses, many have not implemented FIX for fixed income. Leveraging FIX capabilities to support the three-way messaging requirements of the Task Force recommendations could expedite the process. FPL's (FIX Protocol Ltd.) Global Fixed Income Committee (GFIC)[1] would be happy to work with the Task Force to adapt FIX messaging standards and establish best practices to address these needs. Jordan & Jordan can facilitate a discussion if the Task Force wishes to pursue this further.

4. What business impact do you anticipate from the recommendations? For example, what impact would you expect this series of reforms to have on the structure, volumes, collateral, or other parameters of the tri-party repo market?

Jordan & Jordan has no comment.

5. Considering a dealer default scenario, what additional measures should be considered to address concerns regarding potential liquidity pressures on cash lenders and surviving dealers, and the potential for fire-sale conditions?

Jordan & Jordan has no comment.

6. What measures could be taken to reduce the likelihood of cash lenders running from a troubled dealer?

Within the current or proposed tri-party processes there is nothing that Jordan & Jordan can see that would prevent cash lenders from running from a troubled dealer; however, we believe a central counterparty that guarantees all transactions does present a viable solution.

a) Are there ways to increase a lender's ability to effectively deal with a scenario in which it must accept collateral in lieu of cash following a dealer default?

Other than the suggestions put forth in the Task Force recommendations (i.e. more accurate margin and valuation levels, potentially netting of exposures by DTCC and/or utilization of a central liquidation agent), nothing additional can be seen at this time. Once again, however, it should be noted that utilization of a central counterparty would eliminate any need for investors to deal with collateral in the event of a dealer default.

7. What other approaches to assessing and mitigating systemic risk in tri-party repo business arrangements should the Federal Reserve or industry leaders consider?

a) For example, would implementation of a central counterparty be desirable in this market? If so, what specific features of a central counterparty would be most desirable, and why?

While utilization of a central counterparty would eliminate many of the challenges presented by current tri-party activity, Jordan & Jordan understands that cash investors have resisted membership in central counterparties due to the clearing fund and mutualization of loss requirements currently required by these systems.

In response to your whitepaper's invitation to "identify additional or alternative measures that should be considered", Jordan & Jordan agrees that the Federal Reserve should expand beyond the current tri-party model and look for new financing structures that do not present the concerns that have been so well defined in these documents.

[1] Jordan & Jordan manages the global Program Office for FPL and our staff members are active participants in numerous FIX committees including GFIC. The FIX protocol is an open standard, free for all to use in the public domain.

We believe that there are alternative structures that could be utilized in conjunction with a central counterparty that would allow cash investors to obtain the protections and efficiencies of a central counterparty without requiring cash investors to provide clearing fund deposits or have any risk due to mutualization. While such a change would concentrate all risk with the central counterparty and could require changes to how financing is done today, Jordan & Jordan feels that before the effort required to deliver the recommendations of the Task Force is fully expended, further examination of a new, more efficient structure is warranted.

We at Jordan & Jordan would be happy to discuss our ideas in this regard should the FRBNY or representatives of the Task Force be interested. Again, we thank you for the opportunity to respond to FRBNY's whitepaper and share our thoughts on the Task Force's recommendations for tri-party repo reform. We look forward to having further discussion on this important initiative. Please email me at buckmaster@jandj.com , or email Mary Lou Von Kaenel at marylou@jandj.com.

Sincerely,

David Buckmaster
Senior Advisor

cc: Mary Lou Von Kaenel